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UNCLAS HARARE 000112

SIPDIS

STATE FOR AF/S AND AF/EX
NSC FOR SENIOR AFRICA DIRECTOR JFRAZER
USDOC FOR AMANDA HILLIGAS
TREASURY FOR OREN WYCHE-SHAW
PASS USTR FLORIZELLE LISER
STATE PASS USAID FOR MARJORIE COPSON

¶E. O. 12958: N/A

TAGS: [ECON](#) [EINV](#) [ETRD](#) [PGOV](#) [ZI](#)

SUBJECT: Stronger Zimdollar Slows Inflation

¶1. Summary: A 35-40 percent stronger zimdollar has caused the pace of year-on inflation to slow from 620 to 599 percent. This is the first reduction in Zimbabwe's inflation rate since March 2002, when it fell from 116 to 113 percent. The crucial question remains: Can the Reserve Bank (RBZ)'s new currency auctions hold the rate at this level as demand for U.S. dollars increases? End Summary.

Auctions still successful

¶2. Zimbabwe's currency auctions have worked well, moving the GOZ away from an unrealistic official rate of Z\$824:US\$ to a market rate of Z\$3900:US\$. At present, the RBZ has been able to name its rate, since supply far exceeds demand for U.S. dollars. However, demand is picking up. In the three auctions held so far, demand for available U.S. dollars has grown rapidly:

Jan 12 - US\$ 0.5 million
Jan 15 - US\$ 1.2 million
Jan 19 - US\$ 4.2 million

Obviously, the RBZ does not have an unlimited supply of U.S. dollars. At some point in the next month, it is possible demand will exceed supply at the present exchange range. The RBZ must then decide whether it allows the auction rate to drift upwards. If it suppresses the auction rate, however, business will migrate once again to the parallel market.

¶3. The zimdollar's enhanced buying power seems to have brought down year-on inflation. Monthly inflation fell to 11.2 percent in December after peaking at 34 percent in November. However, prices still rose in each of the 10 groupings in the consumer price index.

Comment

¶4. Although the GOZ is enjoying the success of its currency auctions, it will have to do a great deal more to turn the economy around. Artificially low lending rates and surging fees for parastatal services continue to exert inflationary pressures. Public spending is out-of-control. (We are told one ministry has already begun preparing its supplemental funding submission in the first month of the budget year.) Forcing exporters to surrender 25 percent of earnings at an ultra-low official rate beats the previous arrangement but still depresses exports. Post-land reform agriculture remains weak and the tobacco harvest - traditionally accounting for one-third of export revenue - may fall another 25 percent in ¶2004. It remains to be seen how RBZ Governor Gideon Gono will cope with these challenges.

Sullivan